

Appeal from a decision of the New Mexico State Office, Bureau of Land Management, denying request for suspension of overriding royalty interests and declaring interest on net profits not to be qualified as an interest under 43 CFR 3103.3-3. NM LC 03-2510-C.

Affirmed.

1. Oil and Gas Leases: Royalties

The Secretary of the Interior has discretion to suspend overriding royalty interests in excess of 17-1/2 percent pursuant to 43 CFR 3103.3-3. If on appeal an appellant does not show, by a preponderance of available evidence, that rejection of an application for suspension was erroneous the decision rejecting the application will be upheld.

APPEARANCES: Jeffrey D. Hewett, Esq., Midland, Texas, for appellant; Brian D. Miller, Esq., Roswell, New Mexico, for respondent.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

Wood, McShane and Thams (appellant) appeals from a decision of the New Mexico State Office, Bureau of Land Management, dated December 13, 1985, denying its requests for suspension of overriding royalty interests and finding a carried-net-profits interest would not be considered when making a determination whether to suspend an overriding royalty pursuant to 43 CFR 3103.3-3.

Lease NM LC 03-2510-C was issued in 1937 and has been made subject to numerous overriding royalty interests, renewals, and consolidations. It is a producing lease which was committed to the South Leonard Queen Unit on March 1, 1979. Appellant acquired the lease by assignment effective September 1, 1984. The lease is presently subject to a 12-1/2-percent royalty interest reserved by the United States and other nonparticipating overriding royalty interests 1/ totalling 10.03125-percent, resulting in a total

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1/ The various overriding royalty interests were created between 1927 and 1961 and have been the subject of numerous mesne conveyances. The fractional overriding royalties are currently believed to be divided among

nonparticipating burden of 22.53125-percent. In addition, the lease is subject to a 50-percent carried-net-profits royalty interest. All of the overriding royalty interests and the carried net profits royalty interest were acquired prior to appellant's acquisition of the lease.

On December 18, 1984, appellant filed an application for suspension of overriding royalty interests pursuant to 43 CFR 3103.3-3. The regulation provides:

An agreement creating overriding royalties or payments out of the production of oil and gas which, when added to overriding royalties or payments out of production previously created and to the royalty payable to the United States, aggregate in excess of 17 1/2 percent may be suspended by the Secretary at any time upon a determination that the excess constitutes a burden on lease operations to the extent that proper and timely development may be retarded, or continued operation of the lease impaired, or premature abandonment of the wells caused. The limitations in this section shall apply separately to any zone or portion of a lease segregated for computing royalty due the United States.

The Roswell District Office, BLM, denied the application for suspension of royalties because the data regarding appellant's operations, which extended from September through December 1984 was insufficient, and consideration of the 50-percent carried-net-profits royalty interest was deemed inappropriate when making a decision as to whether to grant suspension. Appellant appealed to the BLM, New Mexico State Office. On December 13, 1985, the State Office issued its decision upholding the Roswell District Office. BLM stated:

In support of the application, the applicant submitted a schedule showing a summary of their revenue and expenditures from September 1984 through April 1985. The schedule shows that at the end of April 1985, they were operating at a net loss. It also shows that they had some unusually high expenses but that they are slowly recovering their losses.

The applicant has not operated the lease for a sufficient length of time for the Bureau of Land Management to render a determination that the overrides are a burden on the lease pursuant to 43 CFR 3103.3-3. The overriding royalty interest will

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fn. 1 (continued) 12 parties, or their heirs. Appellant's efforts to serve documents pertaining to this appeal upon holders of these interests have been, for the most part, unsuccessful. Appellant has designated royalties totaling 3-percent as questionable. Although all parties recognized that certain of the royalty interests may no longer exist, this decision is predicated on the presumption that they do. In any case the total outstanding royalty burden appears to be not less than 19.53125-percent, excluding the 50-percent carried-net-profits royalty interest.

not be suspended at this time until more historical production and economic data have been accumulated.

In addition, the net profit interest of Doyle Hartman [Hartman] is not considered either an overriding royalty or payment out of production for the purpose of 43 CFR 3103.3-3.

The interest was created in a conveyance to Prudential Insurance Company of America (Prudential) dated April 1, 1966, from Joseph E. Seagram & Sons, Inc. (Seagram). The Prudential interest is a predecessor of Hartman, and Seagram is a predecessor of Wood, McShane and Thams. The interest of Prudential has been designated as a cost-bearing interest being "50 percent of the net profits, if any." The instrument between Prudential and Seagram also included a clause as to Federal leases providing for suspension of royalties if average production falls below 15 barrels per well per day. The April 1, 1966, conveyance characterizes such interest a "net profits overriding royalty." However, the agreement between Prudential and Seagram provides that it is effective "So long as and to the extent the same may be required by applicable laws or regulations."

The Hartman interest becomes effective only if there is a profit in the lease operation. Hartman asserts that his 50 percent in net profit bears the cost of 50 percent of "all costs, expenditures and expenses." The interest comes into being after production, and the costs, royalties, and other income and expenses inherent in production and lease operations have been determined. If a profit is the final result, the Hartman interest is a beneficiary. Its share of the cost of production is not a true cost-bearing interest attached only to actual production costs but takes into consideration the entire lease operation. The royalties, production payments or other payments out of production provided for in 43 CFR 3103.3-3 burden the operation in that they are recovered from any production from the lease regardless of profit or loss from the entire lease operation. This is what distinguishes the interests in 43 CFR 3103.3-3 from the Hartman interest. Whether an actual profit is the final result may depend on factors other than the actual production and cost of production.

(Decision at 1-2).

On appeal from the New Mexico State Office decision, appellant argues that BLM should have granted suspension because all of the nonparticipating interests including the carried-net-profits interest should fall within the ambit of 43 CFR 3103.3-3. Appellant insists that Hartman holds an overriding royalty interest, because his interest contributes nothing to operations and bears no risk. Appellant argues it presented sufficient economic evidence to establish that the existence and extent of the nonparticipating interests would retard development, impair continued operation of the lease, and risk

premature abandonment of its wells. Appellant claims the New Mexico State Office did not afford sufficient opportunity to submit all of the appropriate economic information. On appeal appellant has submitted supplementary information including maps, graphs, and tables to show present and projected future production data in support of its suspension request.

Doyle Hartman filed a response in opposition to the application for suspension. Hartman maintains that 43 CFR 3103.3-3 does not apply to his cost-bearing net-profits interest. He admits the regulation gives the Secretary of the Interior the discretionary authority to suspend royalty interests, but claims that, absent specific regulatory provisions outlining a procedure by which a lessee or owner of operating rights is to apply for a suspension, such lessee or owner cannot do so.

[1] Regulation 43 CFR 3103.3-3 defines the conditions necessary for suspension of overriding royalty interests. The parties all concede that the total assignment of nonparticipating royalties other than the carried-net-profits interest held by Hartman represents a 22.53125-percent overriding royalty burden, which exceeds the 17-1/2-percent minimum needed to justify suspension set by 43 CFR 3103.3-3. We find nothing which would suggest appellant did not follow a proper course of action when requesting relief.

Hartman asks that the royalties not be suspended. However, the Secretary has the authority to do so, as the total of overriding royalty interests exceeds the royalty necessary to satisfy the regulation, even if the carried-net-profits interest were not included. Nevertheless, he requests a declaration that his interest is not an overriding royalty interest. After reviewing the agreement and the regulation, we find no error in the BLM treatment of the Hartman interest for royalty reduction purposes. 2/

Appellant claims the denial of a suspension was unreasonable. When a party appeals a BLM decision made in the course of its discretionary authority, it is the appellant's obligation to show error in the decision on appeal.

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2/ In its discussion of the Hartman interest BLM stated the "Hartman interest becomes effective only if there is a profit in the lease operations." This statement leads us to believe that, when reaching the conclusion regarding the Hartman interest BLM has improperly cast Hartman's interest as one that should not be taken into consideration when making an analysis of whether "timely development may be retarded, or continued operation of the lease impaired, or premature abandonment of the wells caused." The agreement provides for a carried interest rather than a participating interest. The burden thus imposed will also have an effect upon operations during periods when the operator is incurring losses from the operation. This will affect the operator's discounted cash flow, and will thus have a direct effect upon the operator's decision to continue operations or abandon the well. For the purpose of determining whether to abandon the well or continue operations, the carrying costs are no less a cost of operation than pumping costs, and thus must be taken into account when deciding whether overriding royalties should be suspended.

Appellant has not disputed the BLM determination that the suspension decision should be based upon past production data rather than future projections, nor has appellant provided a specific factual basis which would support a determination that there was insufficient production history regarding appellant's operations at the time of the decision, although it had opportunities to present such information to the BLM District Office and the BLM State Office. On appeal, appellant has submitted additional evidence regarding the nature of the operations it conducted. However, this information does not show error in the BLM holding that, at the time of the decision, there was not sufficient information to make a determination that royalty reduction was warranted.

This Board's decision does not prejudice appellant's opportunity to file a new application for relief. It is evident that a fair rate of return depends upon the economic conditions and other circumstances existing at the time of filing. Shell Oil Co., 52 IBLA 15, 88 I.D. 1 (1981). We note that 43 CFR 3103.3-3 permits relief to be granted "at any time." BLM determined that it did not have sufficient data at the time its decision issued to grant relief. It is possible that additional data, including that submitted to the Board, and subsequent operating history will better illustrate a need for relief afforded by 43 CFR 3103.3.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the New Mexico State Office is affirmed.

R. W. Mullen  
Administrative Judge

We concur:

Franklin D. Arness  
Administrative Judge

Gail M. Frazier  
Administrative Judge

